90-772 No. (1)

Supreme Court, U.S.
FILED
NOV 13 1990
JOSEPH F. SPANIOL, JR.
CLERK

In The Supreme Court of the United States

October Term, 1990

STATE OF OHIO, DEPARTMENT OF TAXATION AND DEPARTMENT OF LIQUOR CONTROL,
Petitioners,

v.

UNITED STATES OF AMERICA, INTERNAL REVENUE SERVICE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTION PRESENTED

Whether pursuant to 11 U.S.C. § 541(a) "property of the estate" includes a debtor's liquor license free from conditions limiting its alienability where state law creating the liquor license simultaneously imposes a condition prohibiting the debtor from transferring the license unless certain state tax obligations are paid?

LIST OF PARTIES

The parties to the proceedings below were Petitioners State of Ohio, Department of Taxation and Department of Liquor Control and Respondent United States of America, Internal Revenue Service. Terwilliger's Catering Plus, Inc. and E. Hanlin Bavely, Trustee, although parties to this action, have not participated in the proceedings giving rise to this petition. As a result, they are not named as parties herein.

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No.

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UNITED STATES OF AMERICA, INTERNAL REVENUE SERVICE,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioners State of Ohio, Department of Taxation and Department of Liquor Control respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Sixth Circuit, entered on August 13, 1990. A petition for rehearing en banc was denied on September 28, 1990.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit issued August 13, 1990 (A-1) is reported at 911 F.2d 1168 (6th Cir. 1990) under the name *In Re Terwilliger's Catering Plus, Inc.* The opinion of the District Court of the Southern District of Ohio, Western Division (A-23) is not reported. The opinion of the United States Bankruptcy Court of the Southern District of Ohio, Western Division (A-28), is reported at 86 B.R. 937 (1988).

JURISDICTION

The decision of the United States Court of Appeals for the Sixth Circuit was issued on August 13, 1990. The jurisdiction of this Court to review the judgment of the Sixth Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The statutes involved in this case are 11 U.S.C. § 541, 11 U.S.C. § 724, 26 U.S.C. § 6323, Ohio Rev. Code § 4301.25, Ohio Rev. Code § 4303.25, Ohio Rev. Code § 4303.26(B)(1), and California Business and Professional Code § 24049, which are reproduced in the appendix.

STATEMENT OF THE CASE

This case arises out of the Chapter 7 bankruptcy case of Terwilliger's Catering Plus, Inc. ("Terwilliger's"). The facts are not in dispute. On the date of the filing of its bankruptcy petition in July 1987, Terwilliger's held a license to sell liquor issued by Petitioner, State of Ohio, Department of Liquor Control. Respondent filed with the bankruptcy court a proof of claim in the amount of $36,734.98 as of the petition date for unpaid employee income tax withholdings, FUTA and FICA taxes, and various interest and penalty assessments made between June 1985 and September 1986. Previously, respondent filed notices of tax liens on April 14, 1986, and December 9, 1986, which by operation of 26 U.S.C. § 6321 attached to Terwilliger's property. Petitioner State of Ohio, Department of Taxation also filed a proof of claim for unpaid sales tax liabilities in the amount of $13,866.43 incurred between 1984 and 1986. Neither party contests the amount or validity of the other's tax claims.

Pursuant to agreement by the parties and by order of the bankruptcy court, the trustee sold the liquor license and the parties' respective rights attached to the proceeds. Subsequently, the license sold for $8,921.00.

The bankruptcy court ultimately held that the sale proceeds

were to be paid to the Respondent. It concluded that an Ohio liquor license was property to which a federal tax lien attached and which was includable in the bankruptcy estate. Ohio's argument that the estate took the license subject to the statutory condition set forth in Ohio Rev. Code § 4303.26(B)(1) that delinquent state taxes be paid prior to transfer was rejected. The bankruptcy court's determination was upheld on appeal by the district court.

On appeal, a divided panel of the Sixth Circuit affirmed the judgment of the District Court.[1] The panel majority declined to accept the state's argument that the federal tax claim could attach to and the debtor's estate consisted of only that portion of the liquor license's value that remained after the state's tax claim was satisfied. (A-19)

The majority below determined that the question to be resolved was not whether the state had reserved a property interest by restricting the transfer of liquor licenses but "whether the state's debt collection method is a property interest that can be asserted in a bankruptcy proceeding to collect debts owed the state ahead of payment of a perfected federal tax lien." (A-10). The majority dismissed as misplaced the state's reliance on *Hyde v. Woods,* 94 U.S. 523 (1877) and *Board of Trade v. Johnson,* 264 U.S. 1 (1924). Instead, the panel majority read *Hyde* and *Board of Trade* as treating limitations on transferability as analogous to common law liens which were entitled to protection under the Bankruptcy Acts of 1867 and 1898, respectively. The court proceeded to apply federal law to determine if the state's "lien-like interest" was entitled to priority over the perfected federal tax lien.

The panel majority found that the state's "lien-like interest" was inchoate because it was not enforceable at the time the state's tax assessment was made. Accordingly, the court

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[1] The courts below also rejected Ohio's claim that a liquor license was not property for bankruptcy and federal tax lien law purposes. This argument is not renewed herein.

concluded that under 11 U.S.C. § 724 and 26 U.S.C. § 6323, the perfected federal tax lien was superior to that of the state and that Respondent was entitled to the proceeds of the sale of the liquor license. (A-13-18). In so finding, the court declined to follow "to the extent they reach a contrary result," the Ninth Circuit's opinions in *In Re Farmer's Markets, Inc.*, 792 F.2d 1400 (9th Cir. 1986); *Matter of Professional Bar, Inc.*, 537 F.2d 339 (9th Cir. 1976); *United States v. California*, 281 F.2d 726 (9th Cir. 1960); and *Meyer v. Bass*, 281 F.2d 728 (9th Cir. 1960). (A-18).

In dissent, Judge Norris criticized the majority for not answering the question of what property interest the debtor had in the liquor license. He suggested that it was first necessary to determine "the nature of the property interest to which the federal tax lien attached." (A-19). This is important, he stated:

> For if state law tells us that the nature of the debtor's property interest in the license was such that the estate received from the debtor an asset which the debtor could not have sold because the state had not conveyed to the debtor the absolute right to sell the license, then we are in no position to characterize the state's reserved interest as a mere collection device. Instead, the state's reserved interest is a property interest as a matter of law.

(A-20).

Judge Norris observed that Ohio law established that a liquor license was wholly created by the state "and that in defining the nature and extent of the property interest to be enjoyed by the holder of the liquor license, the state retained an incident of ownership when it withheld the absolute right to dispose of the license." (A-20). Thus, the debtor's interest in the license was never absolute but limited by the interest retained by the state. Because "the debtor took the license without the reserved incident of ownership, so did the estate." *Id.*

Moreover, Judge Norris found the logic underlying the Ninth Circuit's decisions compelling, noting that it was the same as that employed by the Supreme Court in *Hyde* and *Board of Trade*. He, like the Ninth Circuit, noted that a liquor license had no value unless it could be transferred and that it could not be transferred without first satisfying the owner of the reserved interest against alienation. (A-20-22). Judge Norris concluded that by placing in the bankruptcy estate the license without the transfer limitations reserved by Ohio, the majority had improperly usurped the state's function of creating property. (A-22)., Thus, he would have reversed the judgment of the district court.

REASONS FOR GRANTING THE WRIT

The majority opinion ignores the critical and obligatory first step in implementing the distribution scheme established by the Bankruptcy Code—the determination of the property interest of the debtor which by operation of 11 U.S.C. § 541(a) becomes property of the bankruptcy estate. Instead, by placing the debtor's state-created liquor license in the bankruptcy estate without at the same time recognizing state-created conditions placed on that license, including limitations on its alienability,[2] the majority effectively indulged in the creation of a property right unknown in Ohio law. This holding is in conflict with the principle announced in *Hyde v. Woods,* 94 U.S. 523 (1877) and followed in *Board of Trade v. Johnson,* 264 U.S. 1 (1924), and the holdings of the Ninth Circuit Court of Appeals. Moreover, the majority decision is contrary to the Bankruptcy Code's carefully crafted balance between the right of each state to create

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[2] At least nine other states condition the alienability of liquor licenses on the payment of certain state or local taxes: Alaska (Alaska Stat. § .04.11.280(b) and § .04.11.360(4)); Arizona (Arizona Rev. Stat. § 4-210(A)(5) and (A)(6)); California (Cal. Business and Professional Code § 24049); Hawaii (Hawaii Rev. Stat. § 281-45(b)(1)); Maryland (Md. Ann. Code, art. 2B, § 74(a)(1), (c)(1), (e)(3), (i), (j), and (p)); New Mexico (N.M. Ann. Stat. § 7-1-82(A)(1), § 60-6B-3(E)); Pennsylvania (Penn. Stat. § 4-477(a)(6) and (d)(3)); Rhode Island (R.I. Gen. Laws § 3-5-19); and South Dakota (S.D. Codified Laws § 35-2-7).

and define the property interests of its citizens and the need for a uniform federally defined system for the distribution of a debtor's assets. Accordingly, this case merits full review.

1. It can scarcely be denied that under the Supremacy Clause of the United States Constitution the provisions of the Bankruptcy Code govern this dispute. Pursuant to 11 U.S.C. § 541(a)(1), a bankruptcy estate consists of, most importantly, all legal or equitable interests of the debtor in property at the time of the commencement of the case. Under this provision, to the extent that an interest is limited in the hands of the debtor, it is equally limited in the hands of the bankruptcy estate. 124 Cong. Rec. H. 11,096 (daily ed., September 28, 1978). Moreover, § 541(a) "is not intended to expand a debtor's rights against others more than they exist at the commencement of the [bankruptcy] case." H.R. Rep. No. 595, 95th Cong., 1st Sess. 367-368 (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 82-83 (1978), *reprinted in* 1978 U.S. Cong. and Admin News. at 5868 and 6323. The First Circuit recognized this principle in *In re Gull Air, Inc.,* 890 F.2d 1255, 1261 (1st Cir. 1989), holding "[t]he Bankruptcy Code does not create or enhance property rights of a debtor."

While the Bankruptcy Code does provide that the estate includes all legal or equitable interests of the debtor in property at the time of commencement of the case, it is necessary to look to nonbankruptcy law, usually state law, to determine the debtor's legal or equitable interest, if any, in any particular property. 4 *Collier On Bankruptcy* § 541.02 (15th ed. 1990). Once a debtor's property interests are determined, bankruptcy law controls the transfer and dispostion of that property. The initial inquiry, however—the existence and nature of the debtor's interest in property—is determined by nonbankruptcy law. *Id.; see also In re Polycorp Associates, Inc.,* 47 B.R. 671 (Bankr. N.D. Cal. 1985), *California Bd. of Equalization v. MGM Liquor Warehouse,* 52 B.R. 77 (D. Minn. 1985).

Thus, bankruptcy law, as does federal tax lien law, "creates no property rights but merely attaches consequences, federally defined, to rights created under state law." *United*

States v. Bess, 357 U.S. 51, 55 (1958). Just as in federal tax lien law, "this approach strikes a balance between the traditional interest which the state has in creating and defining the property interests of its citizens and the necessity for a uniform administration of the federal revenue statutes." *Aquilino v. United States,* 363 U.S. 509, 514 (1960). A similar balance is struck in bankruptcy law between the state interest creating and defining property interests and the federal interest in a uniform plan for distribution of a bankrupt's assets. By failing to recognize and give effect to the limited nature of the interests in a liquor license created by Ohio law, the Court of Appeals ignored this statutory accomodation of state and federal concerns.

The correct approach is illustrated by this Court's decisions in *Hyde v. Woods* and *Board of Trade v. Johnson.* In *Hyde,* the Court considered whether a stock exchange rule requiring members' debts first to be satisfied from the proceeds of the sale of the seat was an unlawful preference as against general creditors of the debtor. The Court held:

> Neither the bankrupt law nor any principle of morals is violated by this provision, so far as we can see. A seat in this board is not a matter of absolute purchase. Though we have said it is property, it is incumbent with conditions on purchase, without which it could not be obtained. It never was free from the conditions of Article 15, neither when Fenn bought, nor at any time before nor since. That rule entered into and became an incident of the property when it was created, and remains a part of it into whose hands soever it may come. As the creators of this right—this property—took nothing from any man's creditors when they created it, no wrong was done to any creditor by the imposition of the condition.

94 U.S. at 525. In *Board of Trade v. Johnson,* the Court reaffirmed the principle announced in *Hyde v. Woods,* holding that the creator of an "incorporeal right" could place restrictions on the property at the time of its creation to which

a trustee in bankruptcy would be subject.

Just as the stock exchanges in *Hyde v. Woods* and *Board of Trade v. Johnson* exercised their right to create limited property interests, so too has Ohio. Under the wide ranging authority granted it by the Twenty-First Amendment, *see, e.g., City of Newport v. Iacobucci*, 479 U.S. 92, 95 (1986), and under its police power, Ohio has enacted a comprehensive statutory scheme regulating the distribution and sale of alchoholic beverages. *See* Ohio Rev. Code, Title 43. Only those persons who, upon payment of a fee and approval of their suitability and character by the Ohio Department of Liquor Control, have been issued a license by the state may sell alchoholic beverages. Ohio Rev. Code § 4303.25. (A-43). Ohio has conditioned the interest conveyed to liquor permit holders by providing that:

> [t]he department of liquor control shall not transfer ownership [of a liquor license] until returns known to be delinquent are filed and until any such tax delinquency is resolved. As used in this division, "resolved" means that the tax delinquency has been paid or an amount sufficient to satisfy the delinquency is in escrow for the benefit of the state.

Ohio Rev. Code § 4303.26(B)(1). (A-44). The license could not be obtained, possessed, or transferred without this condition. Thus, the interest created by Ohio law, the license to sell alcholic beverages, is at the same time conditioned by permitting transfer only after state taxes have been paid.

California has a substantially identical statute which disallows the transfer of a liquor license unless the holder pays certain state taxes. See Cal. Business & Professional Code, § 24049. (A-44). In a series of cases, the Ninth Circuit Court of Appeals has concluded that when the holder of a California liquor license becomes a bankrupt, the bankruptcy estate takes as property under 11 U.S.C. § 541(a)(1) only the difference between the proceeds of the license when sold and the taxes due to the state under § 24049. *In Re Farmers Markets, Inc.*, 792 F.2d 1400 (9th Cir.

1986); *Matter of Professional Bar Co., Inc.*, 537 F.2d 339 (9th Cir. 1976); *United States v. California*, 281 F.2d 726 (9th Cir. 1960); *Meyer v. Bass*, 281 F.2d 728 (9th Cir. 1960); *see also In Re Anchorage International Inn, Inc.*, 718 F.2d 1446 (9th Cir. 1983) (holding to same effect under Alaska statute which prohibited transfer of liquor license unless all creditors of business paid). The basis of these holdings is found in *United States v. California*, where, applying *Hyde* and *Board of Trade*, the Ninth Circuit stated:

> Here the license existed because the state had issued it. If the licensee acquired something of value, it was because the state had bestowed it upon him. Whatever value the license, as property, may have had to a purchaser depended upon its transferability. If it was transferable, it was because the state had made it so. If the state had seen fit to impose conditions upon issuance or upon transfer of property it has wholly created, that is the state's prerogative so long as its demands are not arbitrary or discriminatory. The federal government has no power to command the state in this area. It has no power to direct that property be created by the state for purposes of federal seizure.

281 F.2d, at 728.

As in California, a license to sell liquor exists in Ohio only because the state has created it. As in California, its value, particularly in a bankruptcy context, emanates from its transferability. And, as did California, Ohio has reserved an incident of ownership by imposing conditions on transferability at the same time that it created the license. Accordingly, the value of the property possessed by the debtor, and thus the estate, was the sale price of the license reduced by the reserved incident of ownership, the requirement of the payment of state taxes.

Nevertheless, the panel majority mischaracterized Ohio's retained property interest in the liquor license as a mere "debt collection method." (A-10) It concluded erroneously that the "debt collection method" was analogous to an

inchoate lien which was inferior to the perfected federal tax lien. The court's focus on the competing federal and state claims against the debtor ignores the basic question as to the nature and extent of the interest of the debtor that is transferred to the estate. The extent of the property interest transferred to the estate must be determined before the priority claims against the estate are addressed. This fundamental weakness of the panel majority's reasoning was exposed by Judge Norris in his dissenting opinion:

> Rather than characterizing what the state reserved as merely a collection device and then wondering whether that can ever amount to a property interest which the state may assert in bankruptcy, it seems to me we need first to concern ourselves with the nature of the property to which the federal tax lien is said to have attached. For if state law tells us that the nature of the debtor's property interest in the license was such that the estate received from the debtor an asset which the debtor could not have sold because the state had not conveyed to the debtor the absolute right to sell the license, then we are in no position to characterize the state's reserved interest as a mere collection device. Instead, the state's reserved interest is a property interest as a matter of law.

(A-20)

Moreover, the panel majority appears to have premised its conclusion that Ohio's reserved property interest was an inchoate lien at least in part on a misreading of *Board of Trade.* While it is true that the Court did analogize the exchange's reserved property interest to a common law lien, the Court also observed that there were substantial differences between the reserved interest and a common law lien. First, the transferability limitation differed from a common law lien because it did not deprive the owner of possession and enjoyment. Second, the restriction only interfered with and prevented alienation. 264 U.S. at 11. Plainly, the Court in *Board of Trade* used the lien analogy

as an explanatory device and not to convert the issue from a determination of the property possessed by the debtor to one of priorities between creditors. The error of the panel majority's reading is made manifest by the result in *Board of Trade,* for there the exchange member who benefited from the restriction, which was no less inchoate than Ohio's, was entitled to the proceeds of the sale of the seat over the general creditors of the bankrupt.[3]

The issue presented herein is quite unlike that resolved by the Court in *Perez v. Campbell,* 402 U.S. 637 (1971), on which Respondent heavily relied in proceedings before the Sixth Circuit. In *Perez,* the Court invalidated an Arizona statute which conditioned the issuance of a driver's license to a discharged debtor on payment of prebankruptcy debts because the statute directly conflicted with the discharge provisions of the Bankruptcy Act. In contrast, there is no conflict between Ohio Rev. Code § 4303.26(B)(1) and 11 U.S.C. § 541(a) or any other provision of the Bankruptcy Code. Ohio has simply exercised a power reserved to the states by bankruptcy law since well before *Hyde,* the power to create property burdened by such reasonable and non-discriminatory conditions as it chooses to impose. *See, In Re Anchorage International Inn, Inc.,* 718 F.2d at 1451-52.

The dissent of Judge Norris well summarizes the error of the majority opinion:

> It seems to me that the majority is doing precisely what it may not do—creating property by conferring on the estate the unfettered right to transfer the license, an incident of ownership not enjoyed by the debtor.

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[3] The Sixth Circuit majority based its conclusion that the transferability restriction was an inchoate lien on the assumption that an Ohio tax claim against a liquor license was enforceable only at the time of the license's transfer. This is not so. Ohio Rev. Code § 4301.25(A)(5) permits the Department of Liquor Control to revoke or suspend liquor licenses for failure to pay excise taxes. (A-42)

(A-22). Because the majority opinion invades an area reserved to the states under the Bankruptcy Code, this case presents an issue of national importance that should be settled by this Court.

2. An additional reason for granting the petition for a writ of certiorari is that the decision below is in conflict with decisions from the Ninth Circuit. *See, In Re Farmers Markets, Inc.*, 792 F.2d 1400 (9th Cir. 1986); *Matter of Professional Bar Co., Inc.*, 537 F.2d 339 (9th Cir. 1976); *United States v. California*, 281 F.2d 726 (9th Cir. 1960); and *Meyer v. Bass*, 281 F.2d 728 (9th Cir. 1960). As noted earlier, each of the Ninth Circuit decisions involved a provision of California law which like Ohio Rev. Code § 4303.26(B)(1) conditions the transferability of a liquor license upon the payment of state taxes. In each case, the Ninth Circuit concluded that the condition imposed was within the State's prerogative and served to limit the property interest in the hands of the debtor that would pass into the bankruptcy estate under 11 U.S.C. § 541(a). Specifically, in *United States v. California*, the Ninth Circuit rejected the claim of the United States that its perfected tax lien gave it priority over the state's claim for unpaid taxes and entitlement to the proceeds of the sale of the debtor's liquor license by the receiver in bankruptcy. The appellate court held that the property in the estate was that existing after satisfaction of California's statutory condition on transferability, i.e. payment of taxes due. Thus, the state was entitled to payment out of proceeds of the sale of the liquor license before the United States.

In contrast, the Sixth Circuit in the instant case chose not to determine what kind of property right the debtor possessed under Ohio law. Instead, it viewed the question presented as whether a state or the United States had a higher priority and thus the right to receive the proceeds from the sale of the debtor's liquor license. The court below concluded that the transferability restriction imposed on a liquor license by Ohio Rev. Code § 4303.26(B)(1) was merely an inchoate lien on the license and its proceeds. Finding that the United States' tax lien was perfected, the panel majority held that the federal lien was superior to Ohio's inchoate lien and

that the United States was entitled to the proceeds.[4]

The conflict between the decision of the Sixth and Ninth Circuits is apparent, both as to analysis and result. This was recognized by the Sixth Circuit itself, at least with respect to *United States v. California*.[5] (A-18). Moreover, the United States, in its principal brief before the Sixth Circuit, acknowledged the conflict when it asked the Court to reject the doctrine espoused in *In Re Farmer's Markets, Inc., Matter of Professional Bar, Inc., United States v. California*, and *Meyer v. Bass. Brief For The United States As Appellee* at 22-28.

Because the question presented involves the fundamental power of each state to create property rights and the accomodation of this power with the interests served by the bankruptcy law, the need for uniformity is particularly compelling. If the conflict between the circuits is not resolved, the interests and rights of the states within the jurisdiction of the Sixth Circuit will be determined on a legal basis fundamentally different than that which will be applied to determine the interests and rights of those states within the jurisdiction of the Ninth Circuit. Moreover, states within the jurisdiction of other circuits will be left to guess as to which legal standard will be adopted in their circuit. This Court should grant review in this case so that such disparate and uncertain treatment of the fundamental right of the states

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[4] In addition to the Sixth and Ninth Circuits, other federal courts have considered this question. In *In Re Kick-Off, Inc.*, 82 B.R. 648 (Bankr. Mass. 1987), and *In Re Hoffman*, 65 B.R. 985 (D.R.I. 1986), the courts criticized and, like the Sixth Circuit, declined to follow the Ninth Circuit's line of cases. In *California Bd. of Equalization v. MGM Liquor Warehouse*, 52 B.R. 77 (D.C. Minn. 1985), and *Bush Gardens, Inc. v. United States*, 10 B.R. 506 (Bankr. N.J. 1979), the courts followed the rationale of the Ninth Circuit.

[5] The court below, without explanation, said that its decision was "not necessarily in conflict" with the Ninth Circuit's opinions in *In Re Farmer's Market, Inc., Matter of Professional Bar, Inc.* and *Meyer v. Bass*. Nonetheless, it advised that "to the extent they reach a contrary result, we decline to follow them."

regarding the creation of property interests can be resolved. Plainly, this case presents the Court with the opportunity to resolve a conflict between the courts of appeals that is more than "sufficiently crystalized to warrant certiorari if the federal law is to be maintained in any satisfactory uniform condition." *Beaulieu v. United States,* 58 U.S.L.W. 3834 (June 26, 1990) (White, J., dissenting from denial of petition for certiorari).

CONCLUSION

For all the preceding reasons, the Court is urged to grant the writ of certiorari sought by Petitioners.

Respectfully submitted,

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November, 1990

APPENDIX

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RECOMMENDED FOR FULL TEXT PUBLICATION
See Sixth Circuit Rule 24

No. 89-3561

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re: TERWILLIGER'S CATERING PLUS, INC., Debtor,	
E. HANLIN BAVELY, Plaintiff,	ON APPEAL from the United States District Court for the Southern District of Ohio
STATE OF OHIO, DEPARTMENT OF TAXATION, Defendant-Appellant,	
v.	
UNITED STATE OF AMERICA, INTERNAL REVENUE SERVICE, Defendant-Appellee,	

Decided and Filed August 13, 1990

Before: KENNEDY and NORRIS, Circuit Judges, and COHN, District Judge.*

*The Honorable Avern Cohn, United States District Court for the Eastern District of Michigan, sitting by designation.

KENNEDY, Circuit Judge, delivered the opinion of the court, in which COHN, District Judge, joined. NORRIS, Circuit Judge, (pp. 20-23) delivered a separate dissenting opinion.

KENNEDY, Circuit Judge. The United States and the State of Ohio each claim priority in this bankruptcy case to proceeds for the sale of the debtor's liquor license. The United States' claim is based on a valid, perfected federal tax lien filed against all of the debtor's property prior to the bankruptcy proceedings. The state's claim is based on an Ohio statute that prohibits the Liquor Control Commission from approving the sale of a license until the licensee pays all taxes owed to the state. The Bankruptcy and District Courts held that under the priority rules of the Bankruptcy and Tax Codes, the United States was entitled to the proceeds. The State of Ohio appeals, claiming that a liquor license is not property to which a tax lien can attach or which can become part of a debtor's estate. In the alternative, the state argues that even if the license is property, the trustee must still conform to the state's requirement that the state taxes be paid before the license is transferred. For the reasons stated below, we AFFIRM:

I.

This case arises out of the Chapter 7 bankruptcy case of Terwilliger's Catering Plus, Inc. Terwilliger's filed a petition for relief in July 1987. At the time of its filing, Terwilliger's held a class D-1, D-2, D-3, and D-6 liquor license issued by the Ohio Department of Liquor Control. The United States filed a proof of claim stating that the debtor was indebted to it in the amount of $336,734.98 as of the petition date for unpaid employee income tax withholdings, FICA taxes, FUTA taxes, and interest and penalties that were assessed on various dates between December 1985 and September 1986. As a result of the unpaid taxes, a federal tax lien had attached to all of the debtor's property pursuant to I.R.C. §6321. Notices of the liens were filed on April 14, 1986 and December 9, 1986.

The state does not challenge the validity of the IRS liens or the filings that secured them. The State of Ohio also filed a proof of claim with the Bankruptcy Court based on unpaid pre-petition sales tax liabilities of $13,866.43 incurred between 1984 and 1986. The amount and validity of the state tax claims is also undisputed.

The trustee sought permission of the Bankruptcy Court to sell the liquor license free of all state claims. Pursuant to an agreement between the trustee, the United States, and the State of Ohio, the license was sold and the parties' respective rights attached to the proceeds. The license was subsequently sold for $8,921.00.

On June 2, 1988, the Bankruptcy Court issued an opinion, *In re Terwilliger's Catering Plus, Inc.,* 86 Bankr. 937 (1988), holding that the license was property to which the federal tax lien attached and which became part of the debtor's estate. The court rejected the state's argument that the estate took the license subject to the state restriction, reasoning that such a requirement would undermine the federal bankruptcy scheme. On appeal, the District Court affirmed, again rejecting the state's claims.

II.

The State of Ohio first argues that the liquor license is not property to which a tax lien could attach or which could become part of a bankruptcy estate. The state relies on several state court decisions which stand for the proposition that a liquor license is a privilege granted by the State of Ohio and does not give rise to property or contract rights. *See Salem v. Liquor Control Comm'n,* 34 Ohio St. 2d 244 (1973); *Abraham v. Fioramonte,* 158 Ohio St. 213, 226 (1952); *State ex rel. Zugravu v. O'Brien,* 130 Ohio St. 23, 28-29 (1935). The state also points out that a license may be suspended or revoked for many reasons, including the failure to pay excise tax and assigning, transferring, or pledging the liquor license in a manner contrary to commission rules. Ohio Rev. Code

Ann. §4301.27 (Anderson 1989).[1] State law also provides that the Liquor Control Commission is required to cancel permits in the event of the holder's death, bankruptcy, or assignment of the license for the benefit of creditors, except as provided under the Commission's transfer rules. Ohio Rev. Code Ann. §4301.26(B()1) (Anderson 1989); see also Ohio Admin. Code §4303:1-1-14(A) (1989), *infra* note 4.

If the license is not properly within the meaning of the tax lien statute, I.R.C. §6321,[2] then the federal government's tax lien is invalid. If the license is not property within the meaning of the Bankruptcy Code, 11 U.S.C. § 431,[3] then it does not become part of the bankruptcy estate and therefore cannot be sold by the trustee. The IRS argues that the tax lien issue has already been decided by this Circuit's decision in *Paramount Finance Co. v. United States*, 379 F.2d 543 (6th Cir. 1967). *Paramount Finance* involved a dispute between the IRS and the holder of a prior security interest over the proceeds from the sale of an Ohio liquor license seized and sold by the IRS. The Court held that the IRS "was authorized to collect the tax due it from the taxpayer by levy on the seizure of the state liquor license." *Id.* at 544. Nonetheless, the Court directed that the proceeds be used to satisfy the lender's security interest since that interest was perfected long before the IRS tax lien.

The state argues that *Paramount Finance* incorrectly interpreted Ohio law on the legal nature of the debtor's

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[1] The state has not attempted to cancel the license in this case.

[2] R.C. § 6321 provides in relevant part that a federal tax lien is created in the amount of any unpaid tax on "all property and rights to property, whether real or personal, belonging to such person."

[3] Section 541(a)(1) of the Bankruptcy Code, 11 U.S.C. § 541(a)(1), provides that the filing of a petition in bankruptcy creates an estate that consists generally of "all legal or equitable interests of the debtor in property as of the commencement of the case."

interest in a liquor license. The state also asserts that the Court's holding that a tax lien attaches to a liquor license is dictum since the Court ultimately concluded that the tax lien did not have priority. We disagree with both of these assertions. *Paramount Finance,* as a necessary element of the case, decided that a liquor license was property within the meaning of the tax lien statute. Although state law may have changed in the intervening period, we do not believe that the changes, if any, change the outcome of our prior decision. Nevertheless, since *Paramount Finance* did not explain its reasoning, we address the question at greater length here.

The term "property" is not defined by the tax lien statute and numerous cases have held that federal law does not create any rights to property. Instead, courts look to state law to determine what legal interests in property a debtor or taxpayer has and to federal law to determine whether these state-created interests constitute property or rights to which a tax lien can attach. *Butner v. United States,* 440 U.S. 48, 54 (1979); *Aquilino v. United States,* 363 U.S. 509, 513 (1960); *see also United States v. Bess,* 357 U.S. 51, 56-57 (1958) (holding that a cash surrender value of a life insurance policy is subject to a tax lien even though it is not subject to a creditor's lien under state law since the taxpayer would have had access to these funds during his lifetime); *21 West Lancaster Corp. v. Main Line Restaurant, Inc.*, 790 F.2d 92, 97 (1st Cir. 1984) (once state-created rights are determined "federal law governs whether these rights are 'rights to property' to which a tax lien may attach"); Young, *Priority of the Federal Tax Lien,* 34 U. Chi. L.Rev. 723, 726-28 (1967); Note, *Property Subject to the Federal Tax Lien,* 77 Harv. L.Rev. 1485, 1487 (1964) ("[s]tate labels should not control where the realities—the beneficial incidents of ownership—belie them").

21 West Lancaster is particularly instructive. The IRS and the holder of a prior perfected security interest disputed the ownership of the proceeds from the sale of

a liquor license. As in the case before us, the panel acknowledged that a liquor license was not considered "property" and was not subject to a security interest under state law. The Third Circuit nevertheless held that a liquor license constituted "property" or "rights to property" within the meaning of federal law since the state had created rights in the license—it had beneficial value for its holder and could be transferred or sold—sufficient for it to be considered property. 790 F.2d at 356-58.

Like Pennsylvania, Ohio allows a liquor license to be transferred, sold, inherited, and renewed. *See generally* Ohio Rev. Code Ann. §§ 4303.26, 4303.271 and 4303.273 (Anderson 1988) and Ohio Admin. Code § 4301:1-1-14. It is undeniable that a liquor license has pecuniary value to its holder since the license enables the holder to sell alcoholic beverages and can be sold for value. Since the state has vested the owner of a liquor license with these beneficial interests, a liquor license constitutes "property" or "rights to property" within the meaning of federal tax lien law.[4] Although it is true that the state has the right to decide what property interests it wishes to create, it

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[4] Ohio's own regulations appear to contemplate that a liquor license can be sold by a trustee in bankruptcy or the IRS. Ohio Admin. Code § 4301:1-11-14(A) provides in relevant part:

> Upon various applications therefor on forms prescribed and furnished by the department and upon approval thereof by the director of liquor control, permits or interests therein may be transferred.
>
> . . . .
>
> (4)In the case of a bankrupt permit holder to his trustee in bankruptcy, and thereafter from such trustee to a person firm or corporation, at the same location, when such transfer is in connection with the bona fide sale of the business or assets of such bankrupt permit holder, or pursuant to an order of this commission or a court of competent jurisdiction when the applicant or location meet all other necessary requirements under law.
>
> . . . .

cannot thwart the operation of the Tax Code by classifying the interests it has created as something other than property rights.[4]

Similarly, we believe the license constitutes property within the meaning of the Bankruptcy Code. While several Ohio courts have refused to label the rights granted to the licensee as "property rights," the state nonetheless has chosen to grant the licensee rights tantamount to property rights in all but name.[5] While the nature and extent of the debtor's interest are determined by state law, "once that determination is made, federal bankruptcy law dictates to what extent that interest is property of the estate." *In re N.S. Garrott & Sons*, 772 F.2d 462, 466 (8th Cir. 1985). *Cf. In re Tittabawassee Inv. Co.*, 831 F.2d 104 (6th Cir. 1987) (Michigan liquor license with similar restrictions on transferability constitutes property under Michigan law and within the meaning of the Bankruptcy Code.)[6]

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[4] *(cont.)*

(7) In case of the business of a permit holder having been seized by the internal revenue service, to the purchaser of said business from the internal revenue service. In such event, the application for transfer may be signed by an internal revenue agent.

. . . .

(9) An application may be filed for the simultaneous transfer of ownership and location when such transfer is in connection with the bonafide sale of the business or assets of such permit holder, unless otherwise prohibited by law.

[5] As already, noted, Ohio's own regulations appear to contemplate that a liquor license can be transferred to and sold by a trustee in bankruptcy. *See supra* note 4.

[6] The state has not explicitly argued that its statutes restricting the transferability of a liquor license operates to prevent the license from being transferred to the trustee prior to the payment of state tax liabilities, nor could it success fully do so. The bankruptcy code explicitly invalidates restrictions on the transferability of property that prevent property from becoming part of the bankrutpcy estate. 11 U.S.C. § 541(c)(1).

In a related argument, the state asserts that since a liquor license is not property which can be mortgaged or subjected to the claims of creditors under state law, *Alabama*, 158 Ohio St. at 226-27, then a liquor license is also not subject to seizure and sale to satisfy a federal tax debt. However, once we have concluded that the license constitutes property subject to seizure, this argument is foreclosed. Section 6334(c) of the Internal Revenue Code provides that "no property or rights shall be exempt from levy other than the property specifically made exempt by subsection (a)." The Supreme Court has consistently held that the inability of state law creditors to seize a taxpayer's assets in satisfaction of a debt does not prevent the execution of a federal levy. *United States v. Mitchell*. 403 U.S. 190, 204-05 (1971); *see also United States v. Rodgers*, 461 U.S. 677 (1983) (Texas taxpayer's home was subject to foreclosure and sale to satisfy a federal tax lien in spite of a Texas homestead exemption law that prevented the sale of a family home when a debtor's spouse owned an undivided interest in it); *Bess*, 357 U.S. at 57 ("state law is inoperative to prevent the attachment of liens created by federal statutes in favor of the United States"). In interpreting the language of section 6334(c), the Court has explicitly stated that "an exempt status under state law does not bind the federal collector. Federal law governs what is exempt from federal levy." *Mitchell*, 403 U.S. at 204. The Court went on to explain that the language of section 6334(c) "is specific and it is clear and there is no room in it for automatic exemption of property that happens to be exempt from state levy under state law." *Id.* at 205.

III.

The State of Ohio argues in the alternative that even if the license was property subject to the IRS tax lien and became part of the bankrupt estate, the IRS claim could attach only to the portion of the liquor license's value

that remained after the state's tax claim was satisfied.[7] In this regard, the state argues that we should adopt the same analysis of the Ninth Circuit in *In re Farmers Markets, Inc.*, 792 F.2d 1400 (9th Cir. 1986). *In Farmers Markets* and other like cases, the Ninth Circuit interpreted the effect of the Bankruptcy Code on a California statute providing that the state may refuse to transfer ownership of a liquor license when the owner is delinquent in the payment of state taxes. The Ninth Circuit agreed that the license was property that became part of the estate, but noted that in granting the license, the state reserved the right to collect delinquent taxes before subsequent transfers. The reservation of this right, the court held, acted as a limitation on the debtor's property interest in the license. Since the debtor's property interest was thus impaired, "the estate takes the license subject to the restrictions imposed on the debtor by its transferor." *Id.* at 1403. *See also, In re Anchorage Int'l Inn, Inc.*, 718 F.2d 1446 (9th Cir. 1983); *Matter of Professional Bar Co.*, 537 F.2d 339 (9th Cir. 1976); *Meyer v. Bass*, 281 F.2d 728 (9th Cir. 1960). The same principle was applied by the Ninth Circuit to allow the state to enforce its revenue collection provisions when a liquor license was subjected to a tax lien sale. *United States v. State of California*, 281 F.2d 7216 (9th Cir. 1960).

The Ohio statute, Ohio Rev. Code Ann. § 4303.26(B)(1), is similar. It too seeks to prevent license trasnfers when

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[7] The state argues that we adopted this petition in *Paramount Finance* when we stated that the dispute between the IRS and the lender was resolved "[a]fter allowances for expenses and claims." *Paramount Finance*, 379 F.2d at 544. According to the district court's opinion in *Paramount Finance*, the state sales taxes were paid as part of these expenses and claims. *Paramount Finance Co. v. S & C Tavern, Inc.*, 245 F.Supp. 766, 767 (N..Ohio 1965). Any dispute between the State of Ohio and the IRS over the order of payment of state and federal taxes was clearly not before the Court of Appeals, however. Further, the district court opinion makes clear that the parties entered into a private written agreement to pay the state claims and then litigate the right to the remainder of the proceeds. *Id.* Thus the issue of the state's rights to first payment was not before either court.

state taxes remain unpaid. It provides in relevant part:

> The department of liquor control shall not transfer ownership [of a liquor license] until returns known to be delinquent are filed and until any such tax delinquency is resolved. As used in this division, "resolved" means that the tax delinquency has been paid or an amount sufficient to satisfy the delinquency is in escrow for the benefit of the state.

If Ohio may enforce this statute, then the state may be entitled to receive the funds from the sale of the license to satisfy the debtor's state tax obligations. If we find this statute preempted by federal law, then the federal government receives the sale proceeds to satisfy its tax lien.

Relying on the Ninth Circuit cases, the State of Ohio asserts that states which have adopted such a statute have reserved a property interest in the license. However, the reservation of some type of property interest does not answer the question to be resolved in this case. The question is not whether the state has reserved an interest in the license or placed a limitation on the debtor's interest in the license. Rather, the question to be answered is whether the state's debt collection method is a property interest that can be asserted in a bankruptcy proceeding to collect debts owed to the state ahead of payment of a perfected federal tax lien. In a sense, all debt collection methods that purport to attach to a particular interest in property serve to limit a debtor's interest in the property. Nevertheless, many such interests are not effective to secure a debt in bankruptcy or do not gain priority over an after-filed federal tax lien.

The State of Ohio asserts that its property interest, even though it is essentially a debt collection method, should be enforced in a bankruptcy proceeding and against a federal tax lien because it is inherent in the license itself. The state, and the Ninth Circuit cases on which the state

relies, cite two Supreme Court case to support this assertion. In the first of these cases, *Hyde v. Woods*, 94 U.S. 523 (1877), the Court held that the San Francisco Stock and Exchange Board could enforce a membership rule allowing the exchange to sell a member's seat for the benefit of other creditors who were members of the exchange even though the sale of the seat occurred less than four months before the debtor filed for bankruptcy.[8] The assignee in bankruptcy, the forerunner to the present day trustee, argued that the case should be treated as though the debtor had attempted to create a perpetual lien on his property in favor of a class of creditors. The Court rejected this argument, however, noting that it was not the debtor who encumbered the property. Rather, the property was "encumbered with conditions when purchased, without which it could not be obtained." *Id.* at 525. Accordingly, the Court held that the sale and distribution of the funds did not violate the provisions of the Bankrutpcy Code that prevented the preference of certain creditors.

Hyde, if it stood alone, could be distinguished from the case before us. In *Hyde*, the creditors reserved the right to proceed against the property as well as prohibit its transfer prior to the payment of debts to the other members. In essence, the Court recognized that the creditors could enforce what amounted to a lien on the property. In this case, the state has not reserved the right to proceed against the property, but must wait until the license holder wishes to sell the property or until a trustee in bankruptcy or the federal government pursuant to a tax lien attempts to seize and sell the license. The creditors in *Board of Trade of City of Chicago v. Johnson*, 264 U.S. 1 (1924), possessed a similarly limited right. In *Johnson*, the Supreme Court held that the Board of Trade could enforce

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[8] The rule enforced in that case provided "[i]n sales of seats for account of delinquent members, the proceeds shall be applied to the benefit of the members of this Board exclusive of outside creditors, unless there shall be a balance after payment of the claims of members in full. *Hyde*, 94 U.S. at 524.

a membership rule that prohibited a member from selling his seat on the exchange if the member had creditors on the exchange who objected to the sale because of outstanding debts owed them. The rules did not give the creditors or the Board of Trade the right to sell the seat to satisfy the debts, only the right to prevent a sale by the member before satisfaction of the debts related to the Board of Trade. The case involved three disputes. First, the Board of Trade claimed that the seat was not property of the estate within the meaning of the Bankruptcy Code. The Court rejected this argument. *Id.* at 10. Second, the Board of Trade argued that the case could not be resolved in summary proceeding in the bankruptcy court because the license was not in the possession of the trustee. The Court rejected this claim also. *Id.* at 12-13. Finally, the Court addressed the merits of the creditors' claim that they could use the restraint on alienation to prevent the trustee from selling the seat prior to paying the debts owed to the other members. The Court rejected the interpretation of the lower courts that the creditor members had not made a timely objection within the meaning of the membership agreement. *Id.* at 14-15. The Court, citing *Hyde v. Woods,* did not believe that this invalidated the claims on the seat since the preference itself was created by a pre-petition membership agreement. The Court, which had earlier noted that the interest should be treated similarly to a common law lien, *id.* at 12, stated:

> Nor is there any weight to the argument that, as the preference claims of petitioners were not asserted until after bankruptcy proceedings were begun, the transfer to the trustee was rendered free from their objection. Such a claim was negative in Hyde v. Woods, supra. The preference of the member creditors is not created after bankruptcy. The lien, if it can be called such, is inherent in the property in its creation, and it can be asserted at any time before actual transfer. Indeed, the danger of bankruptcy of the member is perhaps the chief reason, and a legitimate one, for creating the lien.

Id. at 15. Accordingly, the Court held that the creditor board members' claims must be satisfied before the trustee could realize any proceeds for the general creditors.

Contrary to the assertion of the State of Ohio, the Supreme Court in these cases did not treat the debt collection method as an absolute property right held by the creditors and an inviolable limitation on the debtor's property rights. Instead, the interest held by the creditors in the two cases was analogous to a common law lien. While the treatment as a lien was implicit in *Hyde,* the Court in *Johnson* specifically noted that it considered the interest created to be analogous to a lien. *Johnson,* 264 U.S. at 11, 15.

From the state's standpoint, treatment of the statutory collection method as a lien promotes its interest in collection state taxes. In cases where the amount of state taxes owed by the licensee far exceeds the value of the license, the trustee might be unable or unwilling to pay the state taxes in order to sell the license. *See, e.g., Sparhawk v. Yerkes,* 142 U.S. 1, 13-14 (1891) (assignees of bankrupt could have reasonably refused to take stock exchange seat as property of the estate where the sale value was less than the debts and membership fees tied to the estate). Since the state statute forbidding transfer contains no provision allowing the state to accept payment in an amount equal to the value of the license, the state and other creditors may well be unable to collect anything from the debtor's ownership of the license. If the state's debt collection method is treated as a lien, then the secured value of the state tax debts can be reduced to the value of the license. *See* 11 U.S.C. § 506.

Under the Bankruptcy Act of 1867 and 1898, respectively, the *Hyde* and *Johnson* Courts determined that the lien-like interests created by the restraint should be protected. If the state's interest is to receive any protection in the case before us, it must qualify as a lien or similar security interest that has priority over a federal

tax lien in a bankruptcy proceeding. *Accord Anchorage Int'l Inn,* 718 F.2d at 1449, 1452 n.8 (treating similar interest created under Alaska law as a lien-like interest under the Bankruptcy Code). We must apply current federal law to determine whether the state's lien-like interest in the license is enforceable and has priority in the case before us.

Both the state and federal liens secure debts in excess of the sale price of the license. Since the holder of the superior lien is entitled to the full proceeds of the license, we need not decide whether the state's interest in the license would be protected in a proceeding where the only competitor for the proceeds to the sale was the trustee. Assuming the state's lien in interest is not avoidable under section 724 of the Bankruptcy Code, 11 U.S.C. § 724, establishes the priority of distribution for property subject to a federal tax lien. It provides in relevant part:

> (b) Property in which the [bankrupt] estate has an interest and that is subject to a lien that is not avoidable under this title and that secures an allowed claim for a tax, or proceeds of such property, shall be distributed—
>
>> (1) first, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is senior to such tax lien;
>>
>> (2) second, to any holder of a claim of a kind specified in sections 507(a)(1), 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5), or 507(a)(6) of this title to the extent of such allowable tax claim that is secured by such tax lien;
>>
>> (3) third, to the holder of such tax lien, to the extent that such holder's allowable tax claim that is secured by

> such tax lien exceeds any amount distributed under paragraph (2) of this subsection;
>
> (4) fourth, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is junior to such tax lien;
>
> . . . .
>
> (c) If more than one holder of a claim is entitled to distribution under a particular paragraph of subsection (b) of this section, distribution to such holders under such paragraph shall be in the same order as distribution to such holders would have been other than under this section.
>
> (d) A statutory lien the priority of which is determined in the same manner as the priority of a tax lien under section 6323 of the Internal Revenue Code of 1954 (26 U.S.C. § 6323) shall be treated under subsection (b) of this section the same as if such lien were a tax lien.

In order for Ohio to prevail, it must be determined that the state lien interest is superior to the federal tax lien within the meaning of section 724. Since bankruptcy law does not dictate whether the state's claim is superior to the federal tax lien within the meaning of section 724(b)(1), we must look to non-bankruptcy law to determine the priority of the state's claim. Where one of the compelling liens is a federal tax lien, the applicable non-bankruptcy law that determines the priority between the liens is federal law. *See In re Darnell,* 834 F.2d 1263, 1266-67 (6th Cir. 1987); *see also Aquilino,* 363 U.S. at 513-14 ("once the tax lien has attached to the taxpayer's state-created interests, we enter the province of federal law, which we have consistently held determines the priority of competing liens asserted against the taxpayer's 'property' or 'rights of property' ").

Where there is a competition between a federal tax lien and a state law lien, priority is determined the general rule that "the first in time is the first in right." *United States v. City of New Britain, Conn.*, 347 U.S. 81, 85 (1954). Unless the competing lien falls into one of the limited categories of liens enumerated in I.R.C. § 6323(a),[9] the federal tax lien need not be filed to gain priority over other interests; it is perfected at the time the lien is assessed. I.R.C. § 6322. As to the state created lien interest, we have said that before it "can even begin the race to file it must be so far specific and perfected that it constitutes a choate lien." *Walker v. Paramount Eng'g Co.*, 353 F.2d 445, 449 (6th Cir. 1965); *see also United States v. State of Vermont,* 377 U.S. 351 (1964); *New Britain,* 347 U.S. at 84-86; *United States v. Security Trust & Sav. Bank of San Diego,* 340 U.S. 47 (1950).

A lien is usually held to choate "when the identity of the lienor, the property subject to the lien, and the amount of the lien are established." *New Britain,* 347 U.S. at 84. Even when these factor are met, however, the state lien holder must show that he had the right to enforce the lien at some time prior to the attachment of the federal lien. For example, in *Security Trust and Savings Bank of San Diego,* a state attachment lien which had priorty over subsequent lien holders under state law was held to be inchoate with respect to a federal state tax lien. The Court noted, "[t]he attachment lien gives the attachment creditor no right to proceed against the property unless he gets a judgment within three years or within such extension as the statute provides. Numerous contingencies might arise that would prevent the attachment lien from ever becoming perfected by a judgment awarded and recorded." 340 U.S. at 50. The Court also believed the choateness rule should be similar

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[9] According to section 6323(a), the federal lien is not effective against "any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (1) has been filed by the Secretary." The lien interest created by the state does not qualify under this provision.

to the rule of priorities established for cases where an insolvent debtor is subject to a tax lien. In those cases, the Court noted "it has never been held sufficient to defeat the federal priority merely to show a lien effective to protect the lienor against other than the Government, but contingent upon taking subsequent steps for enforcing it." *Id.* at 51.[10] Similarly, in *United States v. Scovil,* 348 U.S. 218 (1955), the Court held as an alternative ground for its holding that a landlord's distraint lien for the payment of rent was not sufficiently choate to protect the landlord's lien from a federal tax lien filed three days later. On this point, the Court noted, "[m]oreover, the distress lien was not perfected in the federal sense at the time the Government's liens were filed. Such perfection is, of course, a matter of federal law." *Id.* at 220. The Court reached this conclusion because "[t]he five day period specified by § 41-160 of the South Carolina Code had not elapsed. During this time the tenant-taxpayer could have reacquired any interest the landlord may have had in his property by posting bond as provided by the Code." *Id.*

Similarly, in the case before us the state's lien interest was not enforceable at the time the tax assessment was made.[11] The state's lien interest is only enforceable when the license holder applies to the Commission to renew the license. Further, like the lien at issue in *Scovil,* the state's lien interest is defeated if the taxpayer either pays

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[10] The modern analog of the priority statute for insolvent debtors subject to a federal tax lien is inapplicable to cases that arise under chapter 11. 32 U.S.C. § 3713(a)(2).

[11] Further, at least some portion of the state's lien interest was not certain in amount at the time several of the federal assessments were made. The federal tax assessments were made on four different dates between December 30, 1985 and September 29, 1986. The date of the state tax lien assessments is not contained in the record before us. However, the state's proof of claim filed with the Bankruptcy Court states that six separate sales tax assessments were made for dates including the following months: December 1984; February and March 1985; and June 1985-August 1986.

the tax or posts a bond guaranteeing the payment of a contested tax liability. In this case, at the time the federal tax lien was filed, the state had no right to payment that it could enforce against the liquor license since there was no pending request to renew or transfer the license and no pending hearing to cancel or suspend the license. Accordingly, the lien interest was contingent and therefore inchoate at the time the federal liens were perfected. While our result in this case is not necessarily inconsistent with the decisions of the Ninth Circuit, other than *United States v. State of California,* to the extent they reach a contrary result, we decline to follow them.

The state asserts that our holding will undercut its ability to collect taxes from license holders. This is clearly not the case. The state may still enforce its statute where a federal tax lien has not been placed on the license.[12] Even if the state's debt collection method provides it with limited protection in a bankruptcy proceeding, the state's tax debt has a relatively high priority under section 507 of the Bankruptcy Code, 11 U.S.C. § 507. Further, it is difficult for the state to maintain that it has received less than it would have received outside of bankruptcy. Absent the action of the trustee to sell the license, the state would have had no right to collect its tax obligation by selling the license and applying the proceeds in satisfaction of the state debt.[13] The state desires the Bankruptcy Code's

[12] We do not decide whether the state can generally enforce this provision to gain priority in a bankruptcy proceeding sunder section 724(b)(4) or (d).

[13] Further, if the license does not become part of the bankruptcy estate and cannot be sold by the trustee as part of the sale of the business, it is likely that the state would collect nothing at all. The state has forbidden the debtor from transferring the license independent of the sale of the business. Since the rest of the business would become part of the estate and could be sold by the trustee, then the license itself would be left to expire of its own accord. Even if the trustee could sell the license and the business in one transaction, subject to prior payment of the delinquent state taxes, the trustee could reasonably choose not to do so if the taxes owed to the state were far in excess of the value of the license. The right to prior payment of taxes asserted by the state is not limited to the value of the license.

aid in selling the license, but at the same time wishes to avoid the Code's system for distributing the proceeds from that sale. Should the state wish its tax claims to be paid ahead of the tax liens in the future there are several methods recognized by the Tax Code for doing so. *See, e.g.*, I.R.C. § 6323.

IV.

Accordingly, the judgment of the District Court is AFFIRMED and the case REMANDED for further proceedings not inconsistent with this opinion.

ALAN E. NORRIS, Circuit Judge, dissenting. With several of the conclusions drawn by the majority, I agree. First, I agree that we must look to Ohio law in order to determine what legal interests to property the debtor had. Second, I agree that regardless of whether Ohio law has termed it "property" for state law purposes, whatever legal interests state law says the debtor possessed can be considered "property" within the meaning of federal law.

The majority, after giving lip service to the first proposition, but without ever having answered just what property interest the debtor did have in the liquor license, announces that the question on appeal "is not whether the state has reserved an interest in the licnese or placed a limitation on the debtor's interest in the license." *Ante,* at ____. Instead, the majority posits the rather interesting proposition that "the question to be answered is whether the *state's debt collection method is a property interest* that can be asserted in a bankruptcy proceeding to collect debts owed to the state." *Ante,* at ____ (Emphasis added.)

The term "property" connotes the sum of all the rights and powers incident to the ownership of a thing, including its use, enjoyment, and disposal. This bundle of rights and powers can be divided among a number of persons, each of whom then possesses an interest that is less than absolute ownership.

Rather than characterizing what the state reserved as merely a collection device and then wondering whether that can ever amount to a property interest which the state may assert in bankruptcy, it seems to me we need first to concern ourselves with the nature of the property to which the federal tax lien is said to have attached. For if state law tells us that the nature of the debtor's property interest in the license was such that the estate received from the debtor an asset which the debtor could not have sold because the state had not conveyed to the debtor the absolute right to sell the license, then we are in no position to characterize the state's reserved interests as a mere collection device. Instead, the state's reserved interest is a property interest as a matter of law.

This case does not involve, as the majority seems to imply, a situation where the state is simply regulating the debtor's absolute ownership of property by limiting its right to dispose of it. Instead, reference to Ohio law establishes that the asset was wholly created by the state, and that in defining the nature and extent of the property interest to be enjoyed by the holder of a liquor license, the state retained an incident of its ownership when it withheld the absolute right to dispose of the license. Accordingly, an incident of ownership which a license holder does not receive is one ordinarily enjoyed by the absolute owner of property—the unfettered power to dispose of it. The debtor's property interest in the license, then, never was absolute; from the outset it was limited by the interest the state retained. As the debtor took the license without the reserved incident of ownership, so did the estate.

As pointed out by the majority, the Ninth Circuit Court of Appeals has dealt with a line of cases concerning a California statute, which for all practical purposes is identical to the Ohio statute. The court's logic is compelling. In those cases, it was held that the state's reservation of the right to insist upon the payment of delinquent taxes as a condition precedent to the holder of a liquor license being able to transfer the license, acted as a limitation on the debtor's property interest in the

license, and the debtor's estate therefor took the license subject to the restrictions imposed upon the debtor. The logic underlying these holdings is the same as employed by the Supreme Court in *Board of Trade of City of Chicago v. Johnson,* 264 U.S. 1 (1924) and *Hyde v. Woods,* 94 U.S. 523 (1877), and points out the reasons we should not characterize Ohio's position as an effort to compete with other creditors over the proceeds of the sale of the license. In the hands of the estate the asset had no value unless it could be transferred; and it could not be transferred without accommodating the owner of the reserved interest against alienation. If the taxes owed by the debtor exceeded the value of a freely transferable license, then we can assume the estate, standing in the shoes of the debtor, would not deem it prudent to pay the taxes. If the license did have value in excess of the taxes owed, then that would be the value of the asset which the estate could pursue for the benefit of creditors.

As the Ninth District Court of Appeals pointed out:

> We look not to the competing claims against the debtor, but to the nature of the debtor's property rights in the license. *In In re Professional Bar,* [537 F.2d 339, 340 (9th Cir. 1976] we stated:
>
> The bankrupt estate, insofar as it includes liquor licenses, has only the limited value of the licenses encumbered as they may be by the terms of the statutes which create the licenses and provide the conditions of their transfer. It is to that limited value that any claims against the estate attach.

In re Farmers Markets, Inc., 792 F.2d 1400, 1403 (9th Cir. 1986).

The opinion in *Farmers Market* built upon earlier opinions in which the court's rationale was spelled out even more clearly. For example, in *United States v. California,* 281 F.2d 726 (6th Cir. 1960), the court utilized

language particularly appropriate to the resolution of this appeal.

> Here the license existed because the state had issued it. If the licensee acquired something of value, it was because the state had bestowed it upon him. Whatever value the license, as property, may have had to a purchaser depended upon its transferability. If it was transferable, it was because the state had made it so. If the state had seen fit to impose conditions upon issuance or upon transfer of property it has wholly created, that is the state's prerogative so long as its demands are not arbitrary or discriminatory. The *federal government* has no power to command the state in this area. It *has no power to direct that property be created by the state for purposes of federal seizure.*

281 F.2d at 728 (emphasis added).

It seems to me that the majority is doing precisely what it may not do—creating property by conferring upon the estate the unfettered right to transfer the license, an incident of ownership not enjoyed by the debtor. Because the estate may take no greater an interest than that held by the debtor, the judgment of the district court should be reversed.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

IN RE:	
TERWILLGER'S CATERING PLUS, INC.,	Civil No. C-1-88-0690 Bankruptcy No.1-87-0231 Adversary No. 1-87-0169
Debtor,	
E. HANLIN BAVELY, TRUSTEE,	
Plaintiff,	ORDER AFFIRMING ORDER OF BANKRUPTCY COURT
vs.	
STATE OF OHIO, DEPARTMENT OF LIQUOR CONTROL, et al.,	
Defendants.	

This is an appeal of the Bankruptcy Court decision and judgment of June 2, 1988 pursuant to 28 U.S.C. § 158(a) and Bankruptcy Rule 8001. Before us are the briefs of the appellant, State of Ohio Department of Taxation (doc. 3) and the appellee, the United States (I.R.S.) (doc. 4) as well as the Certificate of Appeal and related documents from the Bankruptcy Court about this matter (doc. 1).

Background

This appeal arises out of the Chapter 7 bankruptcy petition of Terwilligers Catering Plus, Inc. ("Terwilligers"), the holder of an Ohio liquor permit. The bankruptcy trustee is not a party to this appeal. The Internal Revenue Service ("IRS") filed a claim in the Terwilliger bankruptcy action for pre-petition tax liabilities in the amount of $36,178.55, that were secured by a lien against all of Terwilliger's property. The tax liens had been filed several months before the commencement of the bankruptcy. The State of Ohio Department of Taxation ("the State") filed a claim in this bankruptcy for delinquent pre-petition sales tax

due it totaling $13,866.43. The trustee in bankruptcy filed an adversary proceeding to sell the liquior license, Terwilligers having listed its interest in the license as an asset. Pursuant to an agreement between the trustee and the state and the IRS, the liquor license was sold for $8,921.00. The Bankruptcy Court held that the proceeds should be paid to the IRS because: (1) the liquor license is "property" within the meaning of 11 U.S.C. § 541, thus the federal tax lien, which attached to all property in the debtor's estate, gave the IRS priority over the proceeds of the liquor permit sale compared to the State, an unsecured creditor, (2) Ohio Revised Code § 4301.26(B), which permits the State to prevent the sale of any liquor permit until delinquent sales taxes are paid, does not give the State priority to the proceeds of the sale of this permit because the operation of this statute is enjoined by the automatic stay provisions of 11 U.S.C. § 362.

Appellant raises four issues on appeal: (1) whether the Bankruptcy Court erred in treating the permit as property owned and controlled by the debtor; (2) whether the Bankruptcy Court erred when it failed to look to state law on the issue of whether liens attached to the debtor's interest in the liquor permit; (3) whether the Bankruptcy Court erred in determining that the Ohio Rev. Code § 4301.26(B) conflicted with federal bankruptcy law; and (4) whether the Bankruptcy Court erred in finding that the IRS held a secured interest in the liquor permit and that, as such, its claim was superior to that of the State.

Standard of Review

When we review an order of the Bankruptcy Court, we utilize the same standard of review that the court of appeals uses when reviewing a decision of the district court: we uphold findings of fact unless they are clearly erroneous, however conclusions of law, as we have here, are rendered *de novo*. *In re Hunter Sav. Assoc. v. Gabbott Law Offices, Inc.*, 34 Bankr. 368, 374 (S.D. Ohio 1983); *In re R.N. Salem Corp.*, 29 Bankr. 424, 428 (S.D. Ohio 1983); *see also Roth Steel Products v. Sharon Steel Corp.*, 705

F.2d 134, 143 (6th Cir. 1983) (analogous standard of review for court of appeals review of district court decisions).

Analysis

The State's first, second and fourth issues on appeal are related to the questions of whether an Ohio liquor permit is "property" that became part of the bankruptcy estate and to which federal tax liens may attach. If, as the State urges, a liquor permit is not "property," then the IRS could not be a secured creditor and have priority to proceeds of the sale of the liquor permit in question. The State correctly cites *Aquilino v. United States*, 363 U.S. 509, 513 (1960) for the propositions that state law is controlling as to whether there is a property interest in the liquor permit to which federal tax liens can attach. *See also Butner v. United States*, 440 U.S. 48, 54-55 (1979) (state law is determinative as to property rights in assets of bankrupt's estate). The controlling authority in this Circuit as to whether an Ohio liquor permit is a property interest to which federal tax liens attach is *Paramount Finance Co. v. United States*, 379 F.2d 543 (6th Cir. 1967). In *Paramount Finance*, the Sixth Circuit did look to Ohio law—the Ohio Commercial Code—to conclude that an Ohio liquor permit is " 'property' with unique value," in which a creditor could have a security interest. *Id.* at 545. The court concluded, that federal tax liens could attach to the pecuniary worth of an Ohio liquor permit even if the permit holder did not hold title to the permit. *Id.* at 544 n.5 ("The conclusion *contra* of the District Court was erroneous"). In light of *Paramount Finance* which looked to Ohio law to determine the property rights at issue, we conclude that federal tax liens attached to debtor's interest in the Ohio liquor permit and the proceeds from its sale in this case. See 26 U.S.C. §§ 6321 and 6322. Thus, we reject appellants' first, second and fourth arguments on appeal.

Having concluded that the IRS had a lien on the proceeds of the sale of a liquor permit, we must now determine whether the State had some interest in the liquor

license and its proceeds that would entitle it to priority over the IRS, otherwise it would be entitled to distribution of the proceeds under Section 507(a) of the Bankruptcy Code. Under 11 U.S.C. § 507(a)(7), the State is an unsecured creditor and, as such, would be junior to the IRS, a secured creditor, in rights to the proceeds from the sale of the liquor permit. *See* 11 U.S.C. §§ 724, 726.

The State urges that Ohio Revised Code § 4303.26(B)(1) enables it to collect delinquent sales taxes due it prior to the transfer of a state liquor permit, thus, even if the liquor permit could be considered "property" delinquent sales taxes are to be paid prior to any proceeds from a sale of such permit becoming part of the bankruptcy estate. This statute provides:

> (B)(1) When an application for transfer of ownership of a permit is filed with the department, the department shall give notice of the application to the department of taxation. Within twenty days after receiving this notification, the department of taxation shall notify the department of liquor control and the proposed transferee of the permit if the permit holder owes any delinquent sales taxes to this state or has failed to file any sales tax returns, to the extent that such delinquent taxes and delinquent returns are known to the department of taxation at that time. The department of liquor control shall not transfer ownership of the permit until returns known to be delinquent are filed and until any such tax delinquency is resolved. As used in this division, 'resolved' means that the tax delinquency has been paid or an amount sufficient to satisfy the delinquency is in escrow for the benefit of the state. The department of taxation shall notify the department of liquor control of the resolution. After the department of liquor control has received such notification from the department of taxation, the department of liquor control may proceed to transfer ownership of the permit.

Ohio Rev. Code § 4303.26(B)(1) (Anderson Supp. 1987).

We conclude that in the context of a federal bankruptcy proceeding, Ohio Rev. Code § 4303.26(B) cannot operate as the State urges; to do so would violate the automatic stay provision of the Code. The collection of delinquent sales taxes, regardless of what it may be called, seems to us to be "an administrative. . .action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title. . .or to recover a claim against the debtor that arose before the commencement of the case under this title. . . ," 11 U.S.C. § 362(a)(1); thus, it is stayed once a bankruptcy action commences.

Thus, in this context, Ohio Rev. Code § 4303.26(B)(1) conflicts with and is superseded by the Bankruptcy Code pursuant to the Supremacy Clause, U.S. Const. Art. VI, cl.2. The automatic stay provision of 11 U.S.C. § 362(a)(1) enjoins Ohio Rev. Code § 4303.26(B)(1). As this statute does not give the State a super priority to the process from the sale of the liquor license, the operation of 11 U.S.C. § 507(a)(7) leaves the State as an unsecured creditor that is junior to the IRS by virtue the federal tax lien secured by the debtor's property. The State's third argument on appeal also fails.

Conclusion

For the foregoing reasons, upon our *de novo* review of the issues raised by this appeal, we conclude that the decision of the Bankruptcy Court is in accord with the facts presented and the controlling law of this Circuit at this time. Accordingly, we affirm the decision and judgment of Bankruptcy Court entered June 2, 1988 in the matter.

SO ORDERED.

S. Arthur Spiegel
United States District Judge

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

In Re:	)	
	)	
TERWILLIGER'S CATERING PLUS, INC.	)	Case No. 1-87-02314
Debtor	)	
- -	)	
E. HANLIN BAVELY, Trustee	)	Adversary No. 1-87-0169
Plaintiff	)	
v.	)	
STATE OF OHIO, OHIO DEPARTMENT OF LIQUOR CONTROL	)	
and	)	**DECISION**
STATE OF OHIO, DEPARTMENT OF TAXATION	)	
and	)	
DEPARTMENT OF THE TREASURY, INTERNAL REVENUE SERVICE	)	
Defendants	)	

At Cincinnati, in said District, on the 2nd day of June, 1988.

This matter involves the determination of the rights to proceeds upon the transfer of a liquor license by a Chapter 7 trustee. It is essentially a contest between the State of Ohio, Department of Liquor Control and Department of Taxation (State) and the Internal Revenue Service (IRS), the trustee no longer having an interest in the fund.

The debtor, holder of a liquor license, filed a bankruptcy petition under Chapter 7 of the Bankruptcy Code on July 8, 1987. The trustee filed a complaint to sell the liquor license free and clear of liens, naming the appropriate State authorities and also IRS defendants. The trustee sought a preliminary injunction to prevent the State from suspending or otherwise interfering with the sale, and to require the State to undertake and complete the transfer of the liquor license. The trustee and the defendants then agreed that the liquor license could be sold free and clear of liens, and that any liens claimed against the license by the defendants would attach to the proceeds of the sale. The court granted the trustee's application to sell the liquor license to Bernhard Schiefer. Before us now is the question of disposition of the proceeds of the sale.*

The State and IRS have stipulated that the debtor's bankruptcy estate included a D-1, D-2, D-3 and D-6 liquor license issued by the State of Ohio Department of Liquor Control for the period between October 1, 1986 through October 1, 1987, subject to renewal beginning September 1, 1987 at a renewal fee of $838.00. They also stipulated that pursuant to an agreement between the trustee and the State, the license was renewed effective from October 1, 1987 through October 1, 1988 and that the trustee was given authority to sell the liquor license for a total price of $8,921.80 ($921.80 representing the cost of renewal and late penalty). The defendants agreed that the IRS has valid claims against the debtor for pre- petition liabilities for income tax withholding, FICA taxes, FUTA taxes, and interest and penalties in the amount of $36,178.55 which

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* Though the language of the agreement is to allow the sale of the liquor license free and clear of liens, we will treat the question as a broader one. Thus, the question will be viewed as whether the State has a right on any basis to the fund resulting from the sale, superior to that of IRS. This approach is only fair considering the cooperativeness with the bankruptcy process displayed by the State in agreeing to permit the sale to proceed without awaiting the outcome herein.

are secured by all of the property of the debtor, while the State has valid claims against the debtor for pre-petition sales taxes, owing by the licensed enterprise, in the amount of $13,866.43. The defendants say that the sole issue for determination is whether the IRS or the State is entitled to the proceeds of the sale of the liquor license.

The State argues two positions. First, the State says that the liquor license cannot be considered part of the estate of the debtor as the debtor has no legal or equitable interest in the liquor license, for it is just a license or privilege. That being the case, says the State, IRS can have no valid lien on the liquor license. The fund resulting upon transfer of the license, then, should come to the State pursuant to the Ohio statute.

The State's second position is that the bankruptcy estate takes a state issued license, such as the liquor license here, subject to the restrictions imposed by the issuer of the license. Under ORC §4303.26(B)(1), the Department of Liquor Control may not transfer ownership of a liquor permit until tax returns known to be delinquent are filed and any tax delinquency is resolved. "Resolved", as defined by statute, means that the tax delinquency has been paid or an amount sufficient to satisfy the delinquency is in escrow for the benefit of the State. Therefore, the State argues that the claims of creditors, including that of secured creditor IRS, would only apply after the requirements of State law are met.

The IRS, for its part, argues that by virtue of its federal tax lien, notice of which was filed prior to the commencement of the bankruptcy proceeding, it has a secured interest in the amount of $36,179.05 in the property of the debtor, and this includes debtor's liquor license and the proceeds of its sale. IRS says that the State is limited to the rights of one having a priority claim under 28 U.S.C. §507(a)(7) so far as its unpaid state sales taxes are concerned. IRS contends that ORC §4303.26(B)(1) is nothing more than a tax collection statute

and does not create a lien in favor of the State.

The relevant Ohio statute says:

ORC §4303.26 Application for permits.

* * *

> (B)(1) When an application for transfer of ownership of a permit is filed with the department, the department shall give notice of the application to the department of taxation. Within twenty days after receiving this notification, the department of taxation shall notify the department of liquor control and the proposed transferee of the permit if the permit holder owes any delinquent sales taxes to this state or has failed to file any sales tax returns, to the extent that such delinquent taxes and delinquent returns are known to the department of taxation at that time. The department of liquor control shall not transfer ownership of the permit until returns known to be delinquent are filed and until any such tax delinquency is resolved. As used in this division, "resolved" means that the tax delinquency has been paid or an amount sufficient to satisfy the delinquency is in escrow for the benefit of the state. The department of taxation shall notify the department of liquor control of the resolution. After the department of liquor control has received such notification from the department of taxation, the department of liquor control may proceed to transfer ownership of the permit. Nothing in this division shall be construed to affect or limit the responsibilities or liabilities of the transferor or the transferee imposed by Chapter 5739. of the Revised Code.

* * *

Thus, the law of the State of Ohio provides that ownership of a liquor license may not be transferred until any sales tax delinquency on the part of the original owner has been

paid. This Ohio statute comes into play because at the time of the filing of this bankruptcy case, debtor held an Ohio liquor license. The debtor then also was liable to the State of Ohio for delinquent pre-petition sales taxes.

We have reached the conclusion in this proceeding in favor of IRS. We find it necessary first to deal with the question of whether an Ohio liquor license is property within the meaning of 11 U.S.C. §541. It is the law in the Sixth Circuit that an Ohio liquor license is something more than a mere license which can have no attribute of property. In *Paramount Finance Company v. United States,* 379 F.2d 543 (6th Cir. 1967), the court found that one could "transfer to the lender a security interest in the liquor license, as constituting 'property' with unique value." *Id.* at 545. This holding leads inevitably to the conclusion that the liquor license here in question, upon the filing of the bankruptcy petition, became property of the bankruptcy estate within the intendment of 11 U.S.C. §541. *Accord, In re Mason,* 18 B.R. 817 (Bankr. W.D. Tenn. 1982); *In re Hoffman,* 65 B.R. 985 (Bankr. D.R.I. 1986).

Though not expressly stated, it is the position of the State, because it urged upon us *In re Farmers Markets, Inc.,* 792 F.2d 1400 (9th Cir. 1986), that the liquor license in its unmodified form does not enter the bankruptcy estate, but only so much of its value as remains after delinquent sales taxes are assessed, enters the estate. This is a flawed view when one takes into consideration the state of affairs at the moment of the filing of the bankruptcy petition in this case. At that point, debtor was operating premises where liquor was sold, and held a liquor license for that purpose, and upon the filing, debtor's interest in the liquor license entered the bankruptcy estate. With respect to sales taxes, at the time of the filing of the bankruptcy petition, debtor was delinquent in its payment of them. There was not pending at the time of the filing, any transaction for the transfer of the liquor license. At that point, with regard to the delinquent sales taxes, the State owned only a claim against debtor. *See,* 11 U.S.C. §101(4)(A); *Ohio v. Kovacs,* 469 U.S. 274, 280

(1985). thus, at the time of the filing of the bankruptcy petition, ORC §4303.26(B)(1) was inactive. It was only when the trustee in bankruptcy sought to liquidate the liquor license that the State statute by its terms was activated. The State then, by resort to that statute, sought to satisfy the claim which it held on account of delinquent sales taxes.

But this brought into play another provision of the Bankruptcy Code which provides:

11 USC § 362. Automatic stay

> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title. . .operates as a stay, applicable to all entities, of—
>
> > (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title. . .or to recover a claim against the debtor that arose before the commencement of the case under this title. . . ;

* * *

By the terms of the automatic stay provision of the Bankruptcy Code, the State is enjoined, so long as the stay remains in place, from collecting its pre-petition claim. We are of the view that it is not possible logically to distinguish a direct suit to collect pre-petition sales taxes owed to the State from an effort to accomplish the same result by application of ORC §4303.26. We are in agreement with the Court in *In re Aegean Fare, Inc.*, 35 B.R. 923, 928 (Bankr. Mass. 1983), where that court said

that such activity amounted to an attempt to do "indirectly that which the [State of Ohio] is prohibited from doing directly." We hold, therefore, that 11 U.S.C. §362(a)(1) directly enjoins the operation of ORC §4303.26. Further, we hold that this conclusion resolves the present controversy.

At first glance, one might think otherwise, for all that §362 does is enjoin action; it does not determine rights. In order to justify our conclusion, then, we must look further to see whether any rights are slighted by our conclusion. At §362(d), terms and conditions are prescribed whereby the automatic stay of the Bankrupcy Code may be modified. For present purposes, what is there provided is relevant to the extent that one must consider what cause, under §362(d)(1), could be shown to warrant removal of the automatic stay so that the State might assert a preeminent right to the fund resulting upon sale of the liquor license by the trustee. We are unable to envision any cause which the State might show which would warrant modification of the automatic stay. This follows from the fact that the Bankruptcy Code itself prescribes the rights of a creditor such as the State.

That the State was a creditor is clear from 11 U.S.C. §101(9) for, as we have seen, it held a pre-petition claim against the debtor at the time of filing. The State had the right, as a creditor, to participate in any distribution made by the trustee by the filing of a proof of claim pursuant to 11 U.S.C. §501, and this the State had done. A claimant such as the State is given a preferred status as a creditor pursuant to 11 U.S.C. §507(a)(7), in the event that funds become available for distribution by the trustee. In view of these contemplations of the Bankruptcy Code for the treatment of a creditor such as the State, we are left with no doubt that the State would be unsuccessful in securing relief from the automatic stay of §362.

Indeed, the removal of the automatic stay for the purpose of permitting the State to allow operation of ORC §4303.26 would directly contravene those sections of the

Bankruptcy Code to which we have made reference, for the conclusion is simply unavoidable that that statutory provision directly conflicts with those provisions of the Bankruptcy Code. Where that is the case, the State statute must yield because of the supremacy clause, Article VI of the United States Constitution.

We thus reach a conclusion on the issues here presented in favor of IRS. *See, In re Hoffman,* 65 B.R. 985 (D. R.I. 1986); *In re Aegean Fare, Inc.,* 355 B.R. 923, 928 (Bankr. Mass. 1983).

BURTON PERLMAN
U.S. BANKRUPTCY JUDGE

Date of Issuance: June 2, 1988

Cincinnati, Ohio

11 U. S. C. Section 541. Property of the estate

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

. . .

(b) Property of the estate does not include—

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor; or

(2) any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease before the commencement of the case under this title, and ceases to include any interest of the debtor as a lessee under a lease of nonresidential real property that has terminated at the expiration of the stated term of such lease during the case.

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

(d) Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

11 U.S.C. § 724. Treatment of certain liens.

(a) The trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title.

(b) Property in which the estate has an interest and that is subject to a lien that is not avoidable under this title and that secures an allowed claim for a tax, or proceeds of such property, shall be distributed—

(1) first, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is senior to such tax lien;

(2) second, to any holder of a claim of a kind specified in section 507(a)(1), 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5), or 507(a)(6) of this title, to the extent of the amount of such allowed tax claim that is secured by such tax lien;

(3) third, to the holder of such tax lien, to any extent that such holder's allowed tax claim that is secured by such tax lien exceeds any amount distributed under paragrpah (2) of this subsection;

(4) fourth, to any holder of an allowed claim secured by a lien on such property that is not

avoidable under this title and that is junior to such tax lien;

(5) fifth, to the holder of such tax lien, to the extent that such holder's allowed claim secured by such tax lien is not paid under paragraph (3) of this subsection; and

(6) sixth, to the estate.

(c) If more than one holder of a claim is entitled to distribution under a particular paragraph of subsection (b) of this section, distribution to such holders under such paragraph shall be in the same order as distribution to such holders would have been other than under this section.

(d) A statutory lien the priority of which is determined in the same manner as the priority of a tax lien under section 6323 of the Internal Revenue Code of 1954 (26 U.S.C. § 6323) shall be treated under subsection (b) of this section the same as if such lien were a tax lien.

26 U. S. C. Section 6321. Lien for taxes

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

26 U. S. C. Section 6323. Validity and priority against certain persons

(a) Purchasers, holders of security interests, mechanic's lienors, and judgment lien creditors — The lien imposed by section 6321 shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary.

(b) Protection for certain interest even though notice filed — Even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid—

. . .

(d) 45-day period for making disbursements — Even though notice of a lien imposed by section 6321 has been filed, such lien shall not be valid with respect to a security interest which came into existence after tax lien filing, or (if earlier) before the person making such disbursements had actual notice or knowledge of tax lien filing, but only if such security interest —

(1) is in property (A) subject, at the time of tax lien filing, to the lien imposed by section 6321, and (B) covered by the terms of a written agreement entered into before tax lien filing, and

(2) is protected under local law against a judgment lien arising, as of the time of tax lien filing, out of an unsecured obligation.

(e) Priority of interest and expenses—If the lien imposed by section 6321 is not valid as against a lien or security interest, the priority of such lien or security interest shall extend to—

(1) any interest or carrying charges upon the obligation secured,

(2) the reasonable charges and expenses of an indenture trustee or agent holding the security interest for the benefit of the holder of the security interest,

(3) the reasonable expenses, including reasonable compensation for attorneys, actually incurred in collecting or enforcing the obligation secured,

(4) the reasonable cost of insuring, preserving, or repairing the property to which the lien or security interest relates,

(5) the reasonable costs of insuring payment of the obligation secured, and

(6) amounts paid to satisfy any lien on the property

to which the lien or security interest relates, but only if the lien so satisfied is entitled to priority over the lien imposed by section 6321, to the extent that, under local law, any such item has the same priority as the lien or security interest to which it relates.

. . .

(h) **Definitions** — For purposes of this section and section 6324—

(1) **Security interest** — The term "security interest" means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth.

(2) **Mechanic's lienor** — The term "mechanic's lienor" means any person who under local law has a lien on real property (or on the proceeds of a contract relating to real property) for services, labor, or material furnished in connection with the construction or improvement of such property. For purposes of the preceding sentence, a person has a lien on the earliest date such lien becomes valid under local law against subsequent purchasers without actual notice, but not before he begins to furnish the services, labor, or materials.

(3) **Motor vehicle** — The term "motor vehicle" means a self-propelled vehicle which is registered for highway use under the laws of any State or foreign country.

(4) **Security** — The term "security" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by a corporation or a government or political subdivision thereof, with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest

or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

(5) **Tax lien filing** — The term 'tax lien filing" means the filing of notice [referred to in subsection (a)] of the lien imposed by section 6321.

(6) **Purchaser** — The term "purchaser" means a person who, for adequate and full consideration in money or money's worth, acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice. In applying the preceding sentence for purposes of subsection (a) of this section, and for purposes of section 6324.

(A) a lease of property,

(B) a written executory contract to purchase or lease property,

(C) an option to purchase or lease property or any interest therein, or

(D) an option to renew or extend a lease of property, which is not a lien or security interest shall be treated as an interest in property.

(i) **Special rules —**

(1) **Actual notice or knowledge** — For purposes of this subchapter, an organization shall be deemed for purposes of a particular transaction to have actual notice or knowledge of any fact from the time such fact is brought to the attention of the individual conducting such transaction, and in any event from the time such fact would have been brought to such individual's attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routine. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless

he has reason to know of the transaction and that the transaction would be materially affected by the information.

(2) Subrogation — Where, under local law, one person is subrogated to the rights of another with respect to a lien or interest, such person shall be subrogated to such rights for purposes of any lien imposed by section 6321 or 6324.

(3) Forfeitures — For purposes of this subchapter, a forfeiture under local law of property seized by a law enforcement agency of a State, county, or other local governmental subdivision shall relate back to the time of seizure, except that this paragraph shall not apply to the extent that under local law the holder of an intervening claim or interest would have priority over the interest of the State, county, or other local governmental subdivision in the property.

Ohio Rev. Code § 4301.25

(A) The liquor control commission may suspend or revoke any permit issued pursuant to chapters 4301. and 4303. of the Revised Code for the violation of any of the applicable restrictions of such chapters or of any lawful rule of the commission or for other sufficient cause, and for the following causes:

(1) Conviction of the holder or his agent or employee for violating a section of Chapters 4301. and 4303. of the Revised Code or for a felony;

(2) Making any false material statement in an application for a permit;

(3) Assigning, transferring, or pledging a permit contrary to the rules of the commission;

(4) Selling or promising to sell beer or intoxicating liquor to a wholesale or retail dealer who is not the holder of a property permit at the time of the sale or promise;

(5) Failure of the holder of a permit to pay an excise tax together with any penalties imposed by the law relating thereto and for violation of any rule of the department of taxation in pursuance thereof.

(B) When the commission considers the length of a suspension of a permit, it may consider the volume of the business of the permit holder, so that the length of the suspension is in proportion to the seriousness of the offense and the permit holder's business in order that the suspension serve as a penalty and a deterrent. Evidence as to the volume of business of the permit holder may be offered by the permit holder or subpoenaed by the commission.

Ohio Rev. Code § 4303.25 Permit required.

No person by himself or by his clerk, agent, or employee shall manufacture, manufacture for sale, offer, keep, or possess for sale, furnish or sell, or solicit the purchase or sale of any beer or intoxicating liquor in this state, or transport, or import, or cause to be transported or imported any beer, intoxicating liquor, or alcohol in or into this state for delivery, use, or sale, unless such person has fully complied with Chapters 4301. and 4303. of the Revised Code or is the holder of a permit issued by the department of liquor control and in force at the time.

The director of liquor control may adopt rules requiring persons acting in capacities only as sales representatives who solicit permit holders authorized to deal in beer and intoxicating liquors to be registered with the department and may cite for revocation such registrant to the liquor control commission for a violation of such chapters or of the rules adopted by the commission or director.

Ohio Rev. Code § 4303.26 Applications for permit or transfer of permit.

. . .

(B)(1) When an application for transfer of ownership of permit is filed with the department, the department shall give notice of the application to the department of taxation. Within twenty days after receiving this notification, the department of taxation shall notify the department of liquor control and the proposed transferee of the permit if the permit holder owes any delinquent taxes and delinquent returns are known to the department of taxation at that time. The department of liquor control shall not transfer ownership of the permit until returns known to be resolved. As used in this division, "resolved" means that the tax delinquency has been paid or an amount sufficient to satisfy the delinquency is in escrow for the benefit of the state. The department of taxation shall notify the department of liquor control of the resolution. After the department of liquor control has received such notification from the department of taxation, the department of liquor control may proceed to transfer ownership of the permit. Nothing in this division shall be construed to affect or limit the responsibilities or liabilities of the transferor or the transferee imposed by Chapter 5739. of the Revised Code.

Cal. Business and Professional Code § 24049. Transfer of license; Grounds for refusal

The department may refuse to transfer any license when the applicant is delinquent in the payment of any taxes due under the Alcoholic Beverage Tax Law [Rev & Tax C §§ 32011 et seq.], the Sales and Use Tax Law [Rev & Tax C §§ 6001 et seq.], the Personal Income Tax Law [Rev & Tax C §§ 17001 et seq.], or the Bank and Corporation Tax Law [Rev. & Tax C §§ 23001 et seq.], or on unsecured property as defined in Section 134 of the Revenue and Taxation Code, when such tax liability arises in full or in part out of the exercise of the privilege of an alcoholic beverage license, or any amount due under

the Unemployment Insurance Code when such liability arises out of the conduct of a business licensed by the Department of Alcoholic Beverage Control.

(2)

No. 90-772

In the Supreme Court of the United States

OCTOBER TERM, 1990

STATE OF OHIO, DEPARTMENT OF TAXATION, ET AL., PETITIONERS

v.

INTERNAL REVENUE SERVICE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly held with respect to the proceeds from the sale of the debtor's liquor licenses that the claim and lien of the United States for withheld income taxes and employment taxes assessed against the debtor prior to the filing of its petition for bankruptcy took priority over the claim of the State of Ohio for delinquent sales taxes.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A22) is reported at 911 F.2d 1168. The opinion of the district court (Pet. App. A23-A27) is unreported. The opinion of the Bankruptcy Court (Pet. App. A28-A35) is reported at 86 Bankr. 937 (1988).

JURISDICTION

The judgment of the court of appeals was entered on August 13, 1990. A petition for rehearing was denied on September 28, 1990. The petition for a writ of certiorari was filed on November 13, 1990. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

On July 8, 1987, Terwilliger's Catering Plus, Inc. (Terwilliger's) filed a bankruptcy petition under Chapter 7 of the Bankruptcy Code. At the time of that filing Terwilliger's held a liquor license issued by the Ohio Department of Liquor Control. The United States filed a proof of claim stating that the debtor was indebted to it in the amount of $36,178.55* for unpaid withheld employee income taxes, FICA taxes, FUTA taxes, and interest and penalties, all of which had been assessed on various dates between December 1985 and September 1986. As a result of the assessed and unpaid federal taxes, a federal tax lien had attached to all of the debtor's property pursuant to Section 6321 of the Internal Revenue Code. Notices of the federal tax liens had been filed on April 14, 1986, and December 9, 1986. The State of Ohio also filed a proof of claim based upon unpaid pre-petition sales tax liabilities of $13,866.43 incurred between 1984 and 1986. The amount and validity of the several tax claims, the federal tax liens, and the filed notices are undisputed. Pet. App. A2-A3.

The trustee, naming the Internal Revenue Service and state authorities as defendants, sought permission from the Bankruptcy Court to sell the debtor's liquor license free and clear of liens, and sought an order preventing the State from interfering with the sale and requiring it to complete the transfer of the liquor license. Because Ohio Rev. Code Ann. § 4303.26 (Anderson 1989) (see Pet. App. A44) conditions transfer of a liquor license upon payment

* The $336,734.98 appearing at Pet. App. A2 is a typographical error. See Pet. App. A23, A29, and 911 F.2d at 1169.

of taxes owed by the owner, the State of Ohio claimed a prior right to any proceeds of the sale. Pursuant to an agreement between the trustee, the United States, and the State of Ohio, the liquor license was to be sold with the respective rights of the parties attached to the proceeds. The license was sold for $8,921. Pet. App. A3, A29.

The State of Ohio argued in the alternative (1) that the liquor license was not property to which the federal tax lien could attach or which would become part of a bankruptcy estate, and (2) that if the license was part of the bankruptcy estate, it was taken with the restrictions imposed by the issuer in Ohio Rev. Code Ann. § 4303.26, *i.e.*, that it could not be transferred until the State's tax claims against the holder were satisfied. Pet. App. A3, A8, A30. The bankruptcy court rejected both positions and awarded the proceeds of the sale to the United States. Pet. App. A28-A35. The district court affirmed. Pet. App. A23-A27.

A divided panel of the court of appeals affirmed the decision of the district court. The court invoked this Court's decision in *Aquilino* v. *United States*, 363 U.S. 509 (1960), holding that although state law determines what interests a debtor or taxpayer has, federal law determines whether those state-created interests constitute property or rights to property to which the federal tax lien can attach, and determines also "the priority of competing liens asserted against the taxpayer's 'property' or 'rights to property.'" 363 U.S. at 514. Although Ohio courts had refused to label the rights granted to the holder of a liquor license as "property rights," the court of appeals held that since the license had beneficial value for the holder, and could be transferred or

sold, it constituted property subject to the federal tax lien. In so holding, it agreed with the decision of the Third Circuit in a similar case, *21 West Lancaster Corp.* v. *Main Line Restaurant, Inc.*, 790 F. 2d 354 (1986). Pet. App. A3-A8.

The court further held that the restrictions on transfer of a liquor license imposed by Ohio Rev. Code Ann. § 4303.26, did not entitle the State's claim for taxes to priority over the federal tax lien. Those restrictions constituted only a collection device or an encumbrance in the nature of a common law lien. But that lien was not one that authorized the state to proceed against the property. Since the State's lien was thus enforceable only when renewal or transfer of the license was sought—and not at the time the federal tax assessment was made and notice filed—it was contingent and therefore inchoate at the time when the federal tax liens were perfected. Accordingly, pursuant to federal law, which is dispositive under *Aquilino*, the claim of the United States to the proceeds of the sale took priority over the claim of the State. Pet. App. A8-A19.

ARGUMENT

The decision of the court of appeals is correct and is not in conflict with any decision of this Court or any other court of appeals. Further review by this Court is therefore not warranted.

1. Petitioners' assertion (Pet. 5-12) that the decision of the court of appeals conflicts with the decisions of this Court in *Hyde* v. *Woods*, 94 U.S. 523 (1877), and *Board of Trade* v. *Johnson*, 264 U.S. 1 (1924), is mistaken. *Woods* and *Johnson* involved, respectively, memberships in the San Francisco Stock Exchange and in the Chicago Board of Trade, claimed by a trustee in bankruptcy for the

debtor's estate in each case. In *Woods*, the rules of the organization granting membership provided that in case of sale of a membership, the proceeds would go first to the claims of other members. In *Johnson*, the rules provided that a membership could not be sold if other members held claims against the owner. See 264 U.S. at 11. In each case the trustee claimed the membership unencumbered by the claims of members, who asserted that the membership was not property and therefore not part of the bankruptcy estate.

In *Woods* and *Johnson*, this Court, applying federal standards that—at least in *Johnson*—were inconsistent with state court decisions (see 264 U.S. at 8), held that the exchange memberships were property subject to the claim of the trustee in bankruptcy. *Johnson*, 264 U.S. at 8-11; *Woods*, 94 U.S. at 524. The court of appeals in this case followed *Woods* and *Johnson* by holding that the liquor license here was also property subject to the claim of the trustee in bankruptcy. In *Woods* and *Johnson*, this Court then proceeded, however, to recognize the claims of members as "in some respects similar to the typical lien of the common law." *Johnson*, 264 U.S. at 11 (explaining *Woods*). That, too, finds its parallel in this case, since the court of appeals here recognized that "[i]f the state's interest is to receive any protection in the case before us, it must qualify as a lien or similar security interest." Pet. App. A13. At this stage of the analysis, however, the effect of a new element not present in the earlier cases—the federal tax lien—must be considered. As this Court held in *Aquilino*, the relative status of the federal and state liens is determined by federal standards. The court of appeals' decision (see Pet. App. A16-A19) that the federal lien must prevail over the

inchoate state lien does not conflict with any decision of this Court.

2. Petitioner contends (Pet. 12-14) that the Sixth Circuit's interpretation of the Ohio statute in this case conflicts with the Ninth Circuit's interpretation of a somewhat similar California statute in a series of four cases. Of course, the fact that the Sixth Circuit interprets an Ohio statute in a fashion arguably different from the Ninth Circuit's interpretation of a California statute (see Pet. App. A44) does not present a conflict among the circuits warranting review by this Court. The appropriate interpretation of Ohio and California statutes is a question answerable with finality only by the highest courts of each State.

In any event, it seems clear that, with a qualification noted below, there is no conflict here. Petitioner (Pet. 12) asserts conflict with a group of four Ninth Circuit decisions, but three of the four, including the two most recent, involve only an unrelated issue. As discussed above, the dispositive issue in this case is the priority of the federal tax lien, determined—as this Court has held it must be—by federal standards. No federal tax lien was involved in three of the four cases invoked by petitioner as in conflict.

In re Farmers Markets, Inc., 792 F.2d 1400 (9th Cir. 1986), held that despite the objections of California authorities the trustee in bankruptcy could sell the bankrupt's liquor license, but that *in the absence of congressional provision otherwise* (792 F.2d at 1403), the proceeds, or the necessary part thereof, should be applied as provided in Cal. Bus. & Prof. Code § 24049 (West 1985). The court held that the State's refusal to transfer the license violated the automatic stay, although not seriously enough to warrant sanctions. Whether, in the ab-

stract, the Ninth Circuit's characterization of the statutory provisions as "restrictions imposed on the debtor by its transferor" (792 F.2d at 1403) differs significantly from the Sixth Circuit's characterization of the Ohio statutory provisions as a "debt collection method" or "lien" (*e.g.*, Pet. App. A13) is by no means clear, and, for present purposes, is irrelevant in the absence of a competing federal tax lien. *In re Professional Bar Co.*, 537 F.2d 339 (9th Cir. 1976), and *Meyer* v. *Bass*, 281 F.2d 728 (9th Cir. 1960), are similarly unrelated to the issue in this case. Each involved a suit by a trustee in bankruptcy to recover sums paid out from the proceeds of sale of a liquor license as a condition of its transfer. No tax lien was involved.

The court of appeals in this case did acknowledge (Pet. App. A18) that its decision appeared to be inconsistent with the decision of the Ninth Circuit in *United States* v. *California*, 281 F.2d 726 (1960), and declined to follow that case, which involved a federal tax lien subordinated to the State's claim to the proceeds of the bankrupt's liquor license. Yet, although the cases appear to be in some tension, the significant fact regarding *United States* v. *California* is that it was decided 21 days after this Court's decision in *Aquilino*, with no indication that the court was aware either of the *Aquilino* decision or even of the controversy that gave rise to that decision and to *United States* v. *Durham Lumber Co.*, 363 U.S. 522 (1960). Indeed, in contrast with settled doctrine that federal law determines both whether state-created interests constitute "property" (see *Aquilino*, 363 U.S. at 512-514; *21 West Lancaster*, 790 F.2d at 356-358) and "the priority of competing liens asserted against the taxpayer's 'property' or 'rights to property' " (*Aquilino*, 363

U.S. at 514), the Ninth Circuit looked to state law to establish the priority of the State's claim to the proceeds from the bankrupt's liquor license. See 281 F.2d at 727.

In view of the inconsistency between the decision in *United States* v. *California* and this Court's decision in *Aquilino*, it is doubtful whether the Ninth Circuit would, in light of *Aquilino*, follow its earlier decision when a competing federal tax lien was involved. That doubt is, of course, enhanced by the fact, noted above, that in its recent *Farmers Markets* opinion, that court acknowledged (792 F.2d at 1403) that a federal statutory provision otherwise would override the provisions of the California statute on the transfer of liquor licenses. Until the Ninth Circuit, while acknowledging *Aquilino*, follows *United States* v. *California* and subordinates a perfected federal tax lien, we believe that there is no conflict with the decision of the Sixth Circuit in the present case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JANUARY 1991

☆ U. S. GOVERNMENT PRINTING OFFICE: 1991 282061 20296